The Components of GDP in China.

In the US consumers spend around 70% of GDP. Most other developed economies follow this pattern – the UK, Italy, Germany and France are all around 60% of GDP. Even emerging economies such as South Korea and India manage around 55% GDP. China is different. Despite consumption hitting 47% of GDP in the 1990s, it has fallen back in recent times to around 36%.

Part of the reason behind the fall in Chinese consumers' share of GDP is the enormous amount of external demand for Chinese goods. With the world economy growing, many economies have been willing to import cheap manufactured items from China. Therefore exports have been a rising proportion of GDP. If China is to be less reliant on exports and is keen to address its trade surplus with the rest of the world, then finding ways of raising internal consumption are important.

A rising saving rate is one explanation for falling consumption and certainly China does save more than most. The US households manage to save around 1% of income; EU economies manage little more at around 5%. At present the Chinese are managing to save around 15%, but this below the rates of 21% seen a decade ago. The Chinese like, or need, to save because of the costs of higher education and the lack of good public health care. But any major uplift in Chinese savings of late has not come from households. Instead it has been firms and government ploughing profits from a booming economy into US treasury bonds.

Another, more interesting, explanation for following consumption is the amount of GDP which flows to workers as earnings. In the last ten years the share wages to GDP has fallen from 53% to 41%. This compares with a relatively static 56% for the US. This fall in GDP which is apportioned to Chinese workers represents a number of factors. First, an increasing supply of migrant workers from the countryside to the industrialized cities has generated a soft labour market which has kept wages low. Secondly, firms have been incapable of taking on these cheaper workers because capital restrictions for small companies have limited the ability to borrow and increase capital. Thirdly, large firms with access to finance have prospered. Cheap credit has made borrowing easy and this has led to an increase in capital-intensive production processes – which require less

workers. So profits have been readily flowing to companies, rather than to workers. Government policies such as undervaluing the Yuan have also helped to promote exports, which are generally capital intensive.

An obvious remedy is for the government to provide incentives for the service sector of the economy which requires a more labour-intensive production process. Such industries can raise the flow of GDP to workers. Other policies might include a raising of the Yuan and improved health and education systems which would lower the need to save.

Questions

1. Explain the various parts of the consumption function.

2. The Chinese save more than most. Which part of the consumption function would pick up this fact?

3. The Chinese economy, which has capital-intensive production processes, results in a lower share of income for Chinese consumers. Which part of the consumption function picks up this fact?

4. Do you think the Chinese will wish, or be able, to change to a more service-based economy?